services) in 1991 is the same as the percentage decrease of revenues (*i.e.*, from traffic sensitive and trunking services) in 1997.

116. We have considered other options, such as the use of local switching revenues in 1991 and 1997 as adjustment factors, and the use of traffic sensitive revenues in a two step procedure establishing revenue growth before and after the completion of the equal access amortization and transport basket restructuring. We reject the first option, however, because local switching revenues were not representative of traffic sensitive basket revenue growth. We reject the second option because it does not reflect accurately the reduction in traffic sensitive basket revenues after the implementation of the *Transport Restructuring Order*. After the restructuring, traffic sensitive basket revenues decreased because some service categories were moved to the new trunking basket. Thus, 1997 traffic sensitive basket revenues were less than they would have been without restructuring.

117. We recognize that the Commission has not required an "R" value adjustment to the PCI to reflect the end of the amortization of some costs. In addition, the Commission has not previously prescribed a specific methodology for price cap LECs to use when adjusting rates in recognition of the completion of a particular amortization. As noted above, in the *Access Reform First Report and Order*, the Commission decided to align its treatment of the expiration of equal access amortizations with the expirations of the depreciation reserve deficiency and inside wiring amortizations.[165] In that Order, the Commission had before it the question whether any exogenous cost reduction should be required to reflect the end of the equal access cost amortization. The Commission decided to order such a reduction, looking to the depreciation reserve deficiency and inside wiring amortizations, where it had directed price cap LECs to make downward exogenous adjustments to their PCIs but had not specified how that reduction would be accomplished.[166] In none of the three orders did the Commission address or analyze the issue of whether price cap LECs should be required to make an "R" adjustment to the PCI to reflect the completion of the amortizations.[167] Price cap LECs simply made an exogenous cost decrease to their PCIs, without making an "R" value adjustment, and the rates were permitted to go into effect without suspension and investigation or specific consideration of this issue. The Commission also did not require an "R" value adjustment for the removal of payphone costs from the CCL charge coincident with

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[165] *Access Reform First Report and Order*, at ¶ 302.

[166] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 173; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2673-2674, ¶¶ 78-82.

[167] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 173; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2673-2674, ¶¶ 78-82.

the deregulation of LEC payphones in 1996.[168] Like the inside wiring and depreciation reserve deficiency decisions, the Commission did not specifically address the desirability of making an "R" value adjustment to account for the removal of payphone costs from regulated accounts.[169]

118. With regard to the completion of the Other Post Employment Benefits (OPEB) amortization, the Bureau was presented with the issue of whether price cap LECs should be required to adjust the reversal of OPEB costs to account for revenue growth.[170] The Bureau concluded that it would not require the LECs to make an "R" adjustment for the removal of OPEB costs in their 1995 annual access tariff filings, because the Commission had not specifically required such an adjustment in the *First Report and Order*.[171] We do not view this decision of the Bureau as constituting a determination that carriers should not be required to make "R" adjustments when making exogenous adjustments. Rather, it appears to have been based on the fact that the Commission had not specifically required an "R" adjustment. Further, we do not view prior instances of adjustment to price caps to account for the end of amortizations, or the payphone deregulation decision, as governing our differing decision today. Because these orders do not address directly whether an "R" adjustment is appropriate or inappropriate, we do not view the references in the *Access Reform First Report and Order* to the inside wiring and depreciation reserve amortizations as precluding an "R" adjustment here. We therefore conclude, for the reasons given above, that an "R" adjustment is necessary here to remove completely the effects of the initial inclusion of the equal access cost amortization in the PCI.[172]

119. We also reject arguments that we may not lawfully require LECs to make an "R" adjustment absent a rulemaking. Section 61.45(d) of the Commission's rules expressly anticipated that further guidance in the form of a "rule, rule waiver, or declaratory ruling" would be provided by the Commission as discrete exogenous adjustments became necessary. Further, we may lawfully make interpretations of price cap rules and requirements, including Section 61.45(d) pertaining to exogenous adjustments, in the context of declaratory rulings in

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[168] *See In the Matter of Implementation of the Pay Telephone Reclassification and Compensation of the Telecommunications Act of 1996*, CC Docket No. 96-128, 11 FCC Rcd 21233 (1996).

[169] *See In the Matter of Implementation of the Pay Telephone Reclassification and Compensation of the Telecommunications Act of 1996*, CC Docket No. 96-128, 11 FCC Rcd 21233 (1996).

[170] *In the Matter of 1995 Annual Access Tariff Filings of Price Cap Carriers,* DA 95-1631, 11 FCC Rcd 5461, 5471 (1995) (*1995 Suspension Order*).

[171] *1995 Suspension Order,* 11 FCC Rcd at 5471.

[172] *See e.g., Motor Vehicles Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 41-4 (1983) (an agency changing course must supply a reasoned analysis for the change).

tariff investigations. Although our determinations here will have precedential effect, we are not required to conduct a rulemaking to determine that carriers must make an "R" adjustment for the 1997-98 access year in order to remove fully their equal access costs from the PCI.[173]

120. Accordingly, we require U S WEST, SWBT, Bell Atlantic, NYNEX, GTE, Ameritech, BellSouth, Frontier, Nevada Bell, Pacific Bell, Rochester, and SNET to revise their rates to reflect the removal of equal access expenses in accordance with the methodology prescribed herein. This prescription will lead to just and reasonable rates. We also require these LECs to issue refunds, computed by multiplying the difference in the LECs' proposed exogenous cost change for equal access amortization and the Commission's determination of this amount by one-half, which represents the period between July 1 and December 31, 1997. Interest shall be computed on the basis of interest rates specified by the United States Internal Revenue Service.

3. SNET's Calculation of the Initial Equal Access Exogenous Cost Revenue Requirement

a. Background

121. In the *1997 Designation Order*, the Bureau found that SNET is the only price cap LEC that included equal access expenses from prior periods, excluding the 1990 period, in calculating its initial equal access exogenous cost revenue requirement.[174] SNET states that it accurately estimated its equal access exogenous cost adjustment because the Commission's instructions for completing the 1990 annual access tariff filings required LECs to include equal access expenses from prior periods, but not from the "current" period, which at that time was the 1990 period. The Bureau directed SNET to identify the specific part of the instructions for completing the 1990 annual access tariff filings that permitted SNET to include equal access expenses from prior periods, but not from the 1990 period.[175] The Bureau also asked SNET and other parties to discuss how SNET's adjustment should be treated in calculating the exogenous cost reduction required in the *Access Reform First Report and Order*.[176]

b. Discussion

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[173] *See e.g., SEC v. Chenery*, 332 U.S. 194, 203 (1947) (an agency may proceed by ad hoc litigation or rulemaking).

[174] *1997 Designation Order* at ¶ 44.

[175] *1997 Designation Order* at ¶ 44.

[176] *1997 Designation Order* at ¶ 44.

122. SNET is the only LEC that has continued to charge for equal access costs on a per line basis. Because SNET has removed its equal access costs based on growth in the number of lines, we find that SNET did not understate its equal access exogenous cost adjustment. We therefore conclude that SNET reported the correct amortized non-capitalized equal access costs to be removed from the PCI.[177]

4. Ameritech's Equal Access Amortization Revenue Requirement

a. Background

123. In the *1997 Designation Order*, we sought comment on whether Ameritech calculated accurately the equal access amortization revenue requirement associated with the total equal access revenue requirements through the use of internal separations data.[178] The Bureau directed Ameritech to explain how it used its separations information system data to determine the portion of the equal access costs that was amortized, and to document fully the data, assumptions, and methodologies that were used to calculate the equal access costs that were amortized.[179]

b. Discussion

124. We determine that, to be consistent with the methodology it used to set its price caps, Ameritech must use projected data to determine the amount of amortized equal access costs included in price cap rates. When Ameritech determined the amount of non-capitalized expenses to establish its initial price cap equal access rate, it used the projected equal access revenue requirement. Thus, rates that are currently in Ameritech's traffic sensitive PCI are based on those projections and not on actual non-capitalized equal access costs. Ameritech now attempts to reduce its traffic sensitive PCI by the amount of actual equal access costs. Because, however, the equal access rates in Ameritech's PCI are based on projected equal access costs, we direct Ameritech to remove projected equal access costs from its traffic sensitive PCI rather than actual equal access costs. This approach will produce more consistent and verifiable results.

C. Other Billing and Collection Exogenous Cost Increases

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[177] Although AT&T initially questioned SNET's computation of its amortized non-capitalized equal access costs, AT&T subsequently stated that SNET in its Direct Case had explained AT&T's initial concerns. *See* AT&T Opposition to Direct Cases at n. 34.

[178] *1997 Designation Order* at ¶ 45.

[179] *1997 Designation Order* at ¶ 45.

1. Introduction

125. Effective May 1, 1997, the Commission changed the separations rules[180] applicable to Other Billing and Collection (OB&C) Expense.[181] The *OB&C Order* revised these rules to replace the complicated allocation procedures, which relied on user and message counts, with a simple allocation procedure based on a fixed interstate allocation factor of 33 percent or 5 percent, depending on whether the price cap ILEC performs any end user billing on behalf of IXCs.[182]

126. Section 61.45 of the our rules requires price cap ILECs to file adjustments to the PCI for each basket as part of their annual price cap tariff filing.[183] Such adjustments shall include exogenous cost changes, including those caused by changes in our separations rules.[184] As part of their annual price cap tariff filings, the price cap ILECs filed exogenous adjustments to reflect the change in our separations rules.

127. In order to determine the level of its exogenous adjustment, each company calculated its interstate OB&C Expense in the base period[185] using the separations rules in place prior to May 1, 1997 ("former rules") and compared that result to the interstate OB&C Expense calculated, for the same period, using the new fixed allocation factor of either 33% or 5% ("new rules"). The difference between these two amounts formed the basis for the exogenous change. Each company then flowed that difference through its Part 36 and Part 69 models[186] to determine the exogenous cost's effect on each of the four price cap baskets (*i.e.*, common line, traffic sensitive switched, trunking, and interexchange, as well as on the billing

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[180] *See OB&C Order*, 12 FCC Rcd 2679 (1997). Our jurisdictional separations rules are codified as Part 36 of our rules. Carriers commonly refer to that part as the Separations Manual.

[181] OB&C expenses include expenses, such as salary and administrative expenses, associated with the preparation of customer bills, other than carrier access charge bills. Included in this classification are the expenses incurred in the preparation of monthly bills, initial and final bills, the application of service orders to billing records and other miscellaneous items. 47 C.F.R. § 36.380(a).

[182] *Id.* at ¶¶ 13-17.

[183] 47 C.F.R. § 61.45(a).

[184] 47 C.F.R. § 61.45(d)(iii).

[185] 47 C.F.R. §§ 61.3(e) and 61.45(c).

[186] *See* Pacific Bell Direct Case, Attachment OBC-8; U S WEST Direct Case, Exhibit 23; GTE Direct Case, Exhibit C-4.

and collection category.[187] When that process is complete, most of the costs that are shifted to the interstate jurisdiction by the change in our OB&C Expense separations rules are allocated, pursuant to the Part 69 rules, to the billing and collection category and recovered through detariffed charges for non-regulated activities.[188] The remainder of the cost shift, however, is recovered through access charges. This occurs because the rule changes, together with the allocation procedures prescribed by other separations rules, produce not only a direct increase in interstate OB&C Expense but also an increase in other interstate costs and expenses, termed "secondary or trailing effects." Specifically, because OB&C Expense is part of an allocation factor (*i.e.*, "Big Three Expenses")[189] used in separating certain investment costs and expenses that are recovered through access charges, an increase in interstate OB&C Expense indirectly raises other interstate costs and expenses that are assigned to access elements, resulting in an increase in access charges.

128. In this section of the Order, we compare the interstate assignment under our former rules to the interstate assignment under our new rules in order to calculate the magnitude of the exogenous change. If the interstate assignment is understated under the former rules, the exogenous change is overstated under our new rules and it results in an increase in access charges. The analysis below examines in detail the calculations of the interstate OB&C Expense under both the former rules and the new rules as well as the manner in which the companies flow the exogenous change through our Part 69 rules.

2. Background

129. The *1997 Suspension Order* found that U S WEST's OB&C exogenous adjustment of $845,145, which U S WEST claimed was necessary in order to recover the two months of OB&C costs between May 1 and July 1, 1997, raises substantial questions of lawfulness.[190] The Bureau also questioned whether other aspects of U S WEST's treatment of OB&C Expense are lawful. In particular, the Bureau noted that U S WEST's ARMIS Report 43-04 shows that its allocation factors (i.e., the relative usage measurements it is required to use as a basis for allocating OB&C Expense among service categories and between the

[187] Detariffing of Billing and Collection Services, 102 F.C.C.2d 1150, *recon. denied,* 1 FCC Rcd 445 (1986).

[188] 47 C.F.R. § 69.407(d). There may be a direct effect on the common line basket if a company was allocating less than 5 percent of its total OB&C Expenses prior to the May 1, 1997 effective date of the *OB&C Order*.

[189] 47 C.F.R. § 36.112(a).

[190] *1997 Suspension Order* at ¶¶ 47-48, 51.

intrastate and interstate jurisdictions) are inconsistent with its allocation of that expense.[191]

130. In the *1997 Suspension Order*, the Bureau also stated that GTE had not adequately explained why it accounts for more than half of the total OB&C exogenous cost amounts claimed by all ILECs in the April filings. The Bureau found that this anomaly raises substantial questions of lawfulness.[192]

131. The Bureau also found a disparity between the portion of billing revenues that Pacific Bell had allocated to the interstate jurisdiction and the portion of billed toll messages that it had attributed to interstate services. The Bureau noted that Pacific Bell's data submission shows that the share of these toll messages attributed to interstate calls declined by more than 66 percent between the end of calendar year 1994 and the end of calendar year 1995 even though its corresponding interstate revenues (from billing and collection services provided to IXCs) increased slightly during that same year. The Bureau stated that Pacific Bell had not explained how such a precipitous decline in billed interstate messages could have occurred at a time when the associated revenues were increasing. In addition, the Bureau found that Pacific Bell may have overstated its exogenous cost changes by basing its analysis on calendar year 1995 data instead of calendar year 1996 data.[193]

132. In the *1997 Designation Order*, the Bureau directed GTE, Pacific Bell, and U S WEST to explain the process by which they separate OB&C Expense between the intrastate and interstate jurisdictions. Because calculation of an exogenous change requires a comparison of separations procedures used in 1990 (the base year for initializing price caps) with separations procedures used in 1996 (the base year for the 1997 annual access charge filings), the Bureau required the companies to explain and document this separations process for calendar years 1990 and 1996. Further, the Bureau required them to explain and document this process for the intervening years, 1991 through 1995, to provide a basis for evaluating the reasonableness of their transition from 1990 procedures to 1996 procedures.[194]

133. To facilitate its analysis of that process, the Bureau also directed these companies to explain and document the process by which they separate the corresponding revenues, Carrier Billing and Collection Revenues. The Bureau explained that, although the jurisdictional separations of those revenues did not affect the companies' claimed exogenous changes because those revenues are non-regulated, the Bureau intended to use the associated

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[191] *1997 Suspension Order* at ¶ 51.

[192] *Id.* at ¶ 52.

[193] *Id.* at ¶ 53.

[194] *1997 Designation Order* at ¶¶ 50-61.

jurisdictional allocation factors, *i.e.*, the message counts used for separating such revenues, as a basis for evaluating the message counts used for separating the message toll portion of OB&C Expense. The Bureau stated that this evaluation procedure seems reasonable given that the companies apparently used message counts as a basis for separating both revenues and expenses.[195]

134. With respect to GTE only, the Bureau designated for investigation the issue of apportionment of customer services expenses among OB&C Expense and other expense categories because GTE's Category 3 expense appear to be anomalously high and its Category 1 expense appear to be anomalously low compared to the other large ILECs. With respect to Pacific Bell, U S WEST, and GTE, the Bureau designated four other basic issues for investigation: (1) the apportionment of OB&C Expense among Message Toll and other service classes; (2) the separation of Message Toll Expense between the intrastate and interstate jurisdictions; (3) the apportionment of interstate OB&C Expense among access charge elements and categories; and (4) the calculation of the exogenous cost change caused by the rule change.[196]

3. Apportionment of Customer Services Expenses Among Separations Categories by GTE

135. The separations rules require carriers to segregate most customer services expenses (*i.e.*, all expenses recorded in Account 6620 except those attributed to Telephone Operator Expense and Published Directory Listing) among three expense categories: Category 1, Local Business Office Expense; Category 2, Revenue Accounting Expense; and Category 3, All Other Customer Services Expense.[197] In the *1997 Designation Order*, the Bureau required GTE to explain and document the methodology it used, during the period 1990 through 1996, to distribute customer services expenses among these three categories. In particular, the Bureau required GTE to explain why Category 3, All Other Customer Services Expense, grew rapidly during that period, increasing from 18 percent to 28 percent of total customer services expense.[198] The Bureau also required GTE to explain why Category 1, Local Business Office Expense, declined rapidly during that period, decreasing from 60 percent to 47 percent of total

[195] *Id.* at ¶ 50.

[196] *1997 Designation Order* at ¶¶ 50-61.

[197] 47 C.F.R. § 36.376.

[198] *1997 Designation Order* at ¶ 53. The Bureau obtained GTE's expense data from the FCC ARMIS 43-04 Report (1990-96), Rows 7300 and 7310, for GTE.

customer services expense.[199] The Bureau observed that these changes suggest that the 1996 Category 3 expense may mistakenly include a portion of Local Business Office Expense that GTE had properly assigned to Category 1 in 1990.

136. An inappropriate assignment of Category 1 expenses to Category 3 would overstate the OB&C exogenous cost change. Specifically, Category 3 is separated on the basis of Category 1 and Category 2 (OB&C) expenses combined.[200] Because Category 3 is separated based on the Category 2 expenses, an overstatement in Category 3 would result in an overstatement of the OB&C exogenous cost change. The direct effect of the separations change is to increase the interstate share of Category 2 expenses. The separations change also has an indirect effect because the larger the level of expenses in Category 3, the larger the total exogenous cost change, including secondary effects, resulting from the OB&C separations change.

a. Discussion

137. In this section of the Order, we require GTE to reassign its Category 1 and Category 3 customer services expense in proportion to the RBOCs' average Category 1 and Category 3 assignments for calendar year 1996. As discussed in more detail below, requiring GTE to reassign its Category 1 and Category 3 customer services expenses and prescribing an RBOC average allocator of GTE's Category 1 and Category 3 customer services expenses is necessary for three reasons. First, GTE fails to support its assertion that the decrease in Category 1 expenses over the same time period is due to a consolidation of customer service operations as well as a new IXC contract removing the cap on uncollectibles. Second, GTE fails to support its assertion that the growth in Category 3 customer services expenses between 1990 and 1996 is due to appropriately assigned expenses and an increase in public telephone commissions. Finally, GTE fails to provide sufficient data to enable us to make a prescription by using GTE-specific data.

(1) Category 1 Expense

138. Although GTE asserts that Category 1 expenses *decreased* as a result of consolidation of customer service centers, this assertion is inconsistent with its statement that this same consolidation substantially *increased* customer service expenses. Moreover, as noted above, GTE improperly assigned those increasing customer service expenses to Category 3 instead of Category 1. Further, GTE fails to provide any documentation to support its assertion that Category 1 expenses declined due to consolidation. GTE does not

199 *1997 Designation Order* at ¶ 53. The Bureau obtained GTE's expense data from the FCC ARMIS Report 43-04 (1990-96), Rows 7220 and 7310, for GTE.

200 47 C.F.R. § 36.382(a).

identify, for example, the magnitude of any of these consolidation-related changes, *i.e.*, the related decrease in Category 1 expense or the related increase in Category 3 expense. It therefore is unclear whether, after all these customer service expenses are properly classified in Category 1, the net effect of the consolidation was to increase or decrease Category 1 expense. Accordingly, GTE's showing is insufficient to establish that this consolidation explains the decline in Category 1 expense.

139. We also are not convinced by GTE's argument that Category 1 expenses declined partly due to the decrease in IXC uncollectibles. GTE does not identify the size of the reduction in uncollectibles. Nor does GTE identify the amount of uncollectibles incurred in 1996. GTE's showing therefore fails to explain why Category 1 expense decreased 23 percent in that calendar year.[201] Further, because GTE states that the decrease in uncollectibles began in 1996, this change cannot explain the 9 percent decrease in Category 1 expense that occurred in the prior year.[202] GTE thus does not demonstrate that the reduction in uncollectibles is primarily responsible for the decrease in Category 1 expense from 60 percent to 47 percent of total customer services expense between 1990 and 1996.

140. For these reasons, we find that GTE's showing regarding the changes to Category 1 and Category 3 customer services expenses between 1990 and 1996 does not adequately address the concerns raised by the Bureau in the *1997 Designation Order*. As the Bureau noted in the *1997 Designation Order*, GTE's Category 3 assignment in 1996 was unusually large compared to that of the RBOCs.[203] In that year, the share of customer services expense that GTE assigned to Category 3 was more than double the largest Category 3 share assigned by any RBOC. Whereas the Category 3 expenses for individual RBOCs ranged from .03 percent to 13 percent of the total customer services expense, GTE's Category 3 expense was 28 percent of total customer services expenses.[204] Further, during the same year, GTE assigned an unusually low share of customer services expense to Category 1. Whereas that share ranged from 70 percent to 82 percent for individual RBOCs, GTE's share was only 47 percent.[205] Because GTE's response fails to explain these anomalies, we are not persuaded that GTE properly classified its 1996 Category 1 and Category 3 expenses.

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[201] FCC ARMIS Report 43-04 (1995-1996) Row 7220, for GTE.

[202] FCC ARMIS Report 43-04 (1994-1995) Row 7220, for GTE.

[203] *1997 Designation Order* at ¶ 53.

[204] FCC ARMIS Report 43-04 (1996), Rows 7300 and 7310, for Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, U S WEST, and GTE.

[205] FCC ARMIS Report 43-04 (1996), Rows 7220 and 7310, for Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, U S WEST, and GTE.

(2) Category 3 Expense

141. Except for public telephone commissions, GTE misassigned customer service administration expenses to Category 3 expense because these expenses are end-user service expenses that must be assigned to Category 1 subcategories: End-User Order Processing, End-User Payment and Collection, and End-User Billing Inquiry.[206] These customer service administration expenses are Category 1 expenses, regardless of whether such services are provided in English or Spanish, because our rules do not distinguish customer services provided in other languages.[207] Moreover, these customer service administration expenses are Category 1 expenses, even though the expenses in question are incurred in decentralized "local" offices or, in GTE's case, in consolidated offices serving customers at a regional or national level because the rules applicable to these three types of Category 1 expenses do not limit such expenses to costs incurred in offices located near the customers served.[208] The rules applicable to end-user billing inquiry expense, for example, do not distinguish between local and regional service centers. Instead, these rules simply state that this subcategory "includes expenses related to handling end users' inquiries concerning their bills."[209]

142. Although Category 1 is titled "Local Business Office Expense," this title does not exclude service expenses incurred outside a customer's local calling area. Rather, the title uses the descriptive term "local" because carriers have traditionally provided these customer services in their local business offices. If carriers now perform some of these services outside the local area, their remote facility provides the same customer service function and thus constitutes, for separations purposes, an extension of the local business office functions. We therefore find that GTE should have assigned these expenses to Category 1 instead of Category 3.

143. GTE claims that the increase in Category 3 expense between 1990 and 1996 is due partly to an increase in public telephone commissions, but GTE does not quantify the magnitude of that increase in commissions. GTE does show, however, that the total amount

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[206] 47 C.F.R. § 36.377(a)(1) through (a)(3). Category 1, Local Business Office Expense, also includes four other subcategories: Interexchange Carrier Service Order Processing, Interexchange Carrier Payment and Collection, Interexchange Carrier Billing Inquiry; and Coin Collection and Administration. 47 C.F.R. §§ 36.377(a)(4) through (a)(7).

[207] *Id.*

[208] *Id.*

[209] 47 C.F.R. § 36.377(a)(3).

of these commissions at the end of the 1990-1996 period was $31.5 million,[210] which is only one-half the size of the $62 million increase in Category 3 expense that occurred during that same period. GTE thus fails to demonstrate that an increase in these commissions had a significant effect on the level of Category 3 expense.

(3) Prescription

144. We require GTE to reassign its Category 1 and Category 3 customer services expense in proportion to the RBOCs' average Category 1 and Category 3 assignments for calendar year 1996. We are using this approach because, as explained above, GTE fails to justify its assignments and does not provide us with the data necessary to make a prescription with GTE-specific data. The *1997 Designation Order* required GTE to provide detailed information to support its Category 1 and Category 3 assignments.[211] In addition, after GTE filed its direct case, the Bureau staff requested additional information from GTE on these assignments.[212] Despite these repeated requests, GTE did not provide sufficient data from which we can make a prescription. Specifically, GTE provided no data that quantify Category 3 expenses associated with consolidation activities.[213] In addition, GTE failed to provide data on the increase in public telephone commissions. Further, GTE did not file any data that documents the alleged decrease in Category 1 expenses due to consolidation. Finally, GTE provided no data regarding the decrease in uncollectibles due to the renegotiation of a contract which GTE indicates is also responsible for the decrease in Category 1.

145. Because GTE provided no data regarding the magnitude of these individual decreases and increases in Categories 1 and 3 expenses, it is not possible to quantify the misallocation to its 1996 Category 1 and Category 3 expenses relying solely on GTE's 1996 data. Accordingly, we prescribe for GTE a reassignment of its Category 1 and Category 3 customer services expense in proportion to the RBOCs' average Category 1 and Category 3 assignments for calendar year 1996. It is reasonable to reassign these expenses by using an RBOC average because we would expect that if GTE had appropriately assigned its Category

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[210] Letter from W. Scott Randolph, Director-Regulatory Matters, GTE to William F. Caton, FCC, at 11, dated September 26, 1997.

[211] *1997 Designation Order* at ¶ 53.

[212] Letter from W. Scott Randolph, Director-Regulatory Matters, GTE to William F. Caton, FCC, at 1, dated September 18, 1997; Letter from W. Scott Randolph, Director-Regulatory Matters, GTE to William F. Caton, FCC, at 2, 9, and 11, dated September 26, 1997.

[213] Letter from W. Scott Randolph, Director-Regulatory Matters, GTE to William F. Caton, FCC, at 1, dated September 18, 1997; Letter from W. Scott Randolph, Director-Regulatory Matters, GTE to William F. Caton, FCC, at 11, dated September 26, 1997.

1 and Category 3 expenses, the relative proportions would be similar to those of the RBOCs. We find this to be case because the RBOCs are similar in operating size to GTE. The RBOCs operating revenues, for example, range from $8 billion (Pacific Telesis) to $14 billion (BellSouth) with GTE having almost $13 billion in operating revenues.[214] Similarly, the RBOCs have Total Billable Access Lines in the range of 14 million (Southwestern Bell) to almost 22 million (BellSouth) while GTE has approximately 17 million.[215]

146. We find that prescribing expense assignments on the basis of an RBOC average, as we do in this Order, is consistent with our authority under Section 205(a) of the Communications Act. Section 205(a) provides in pertinent part that, whenever "after full opportunity for hearing, . . . the Commission shall be of opinion that any charge . . . of any carrier or carriers is or will be in violation of any of the provisions of this Act, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge."[216] Courts have consistently found in the Act a Congressional intent to grant us broad discretion in "selecting methods . . . to make and oversee rates."[217] In doing so, we may make any "reasonable selection from the available alternatives."[218] Rather than insisting upon a single regulatory method for determining whether rates are just and reasonable, courts and other federal agencies with rate authority similar to our own evaluate whether an established regulatory scheme produces rates that fall within a "zone of reasonableness."[219] For rates to fall within the zone of reasonableness, the agency rate order must constitute a "reasonable balancing" of the "investor interest in maintaining financial

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[214] FCC ARMIS Report 43-01 (1996) Row 1090 for Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, U S WEST, and GTE.

[215] FCC ARMIS Report 43-01 (1996) Row 2150 for Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, U S WEST, and GTE.

[216] 47 U.S.C. § 205(a).

[217] *MCI Telecommunications Corp. v. FCC,* 675 F.2d 408, 413 (D.C. Cir. 1982) (quoting *Aeronautical Radio v. FCC*, 642 F.2d 1221, 1228 (D.C. Cir. 1980), *cert. denied,* 451 U.S. 920 (1981)). *See also Western Union Int'l v. FCC,* 804 F.2d 1280, 1292 (D.C. Cir. 1986) ("The FCC's judgment about the best regulatory tools to employ in a particular situation is . . . entitled to considerable deference from the generalist judiciary."); MTS and WATS Market Structure, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241, 259 (1983) ("[A] prescribed rate is just and reasonable for purposes of Section 205(a) if it represents the best approximation of a rate that satisfies all statutory requirements that this Commission is capable of devising within a reasonable period of time.").

[218] *MCI Telecommunications,* 675 F.2d at 413.

[219] *See, e.g., FERC v. Pennzoil Producing Co.,* 439 U.S. 508, 517 (1979); *AT&T v. FCC,* 836 F.2d 1386, 1390 (D.C. Cir. 1988) (quoting *Jersey Cent. Power & Light v. FERC,* 810 F.2d 1168, 1177 (D.C. Cir. 1987)). *See also Wisconsin v. FPC,* 373 U.S. 294, 309 (1963); *FPC v. Natural Gas Pipeline Co.,* 315 U.S. 575, 585-86 (1942).

integrity and access to capital markets and the consumer interest in being charged non-exploitative rates."[220]

147. Our discretionary authority to prescribe rates based on averaging is directly supported by the Supreme Court's decision in the *Permian Basin Area Rate Cases.*[221] In that decision, the Court upheld the Federal Power Commission's (FPC) decision to depart from its former practice of determining the reasonableness of natural gas producers' rates by examining the costs of each company on a case-by-case basis.[222] The Court found that the FPC's decision to prescribe maximum area rates for interstate natural gas sales based on composite cost data obtained from published sources and from producers through a series of cost questionnaires, fell within the "zone of reasonableness" required by the Natural Gas Act.[223] The Court emphasized that the Natural Gas Act had conferred upon the FPC broad responsibilities to regulate interstate distribution of natural gas and that prescribing rates based on composite industry data was a valid exercise of the FPC's discretionary authority under the Act:

> [T]he "legislative discretion implied in the rate making power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself." It follows that rate-making agencies are not bound to the service of any single regulatory formula; they are permitted, unless their statutory authority otherwise plainly indicates, "to make the pragmatic adjustments which may be called for by particular circumstances."[224]

148. In light of our broad discretion to select appropriate regulatory tools for ratemaking purposes, we have, on other occasions, made rate prescriptions based in part on an industry-wide average or mean. Our decision in this investigation to make rate prescriptions on the basis of RBOCs average expense assignments is consistent, for example, with the

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220 *Jersey Cent. Power & Light,* 810 F.2d at 1177-78. *See Pennzoil Producing,* 439 U.S. at 517 (to fall within the zone of reasonableness, rates must be neither "less than compensatory" nor "excessive.").

221 390 U.S. 747 (1968).

222 *Id.* at 768-70.

223 *Id.* at 768-74. The Court noted that Congress had entrusted the regulation of the natural gas industry to the "informed judgment of the Commission," and stated that "a presumption of validity therefore attaches to each exercise of the Commission's expertise." *Id.* at 767.

224 *Id.* at 776-77 (citations omitted). The Court cited as precedent *Los Angeles Gas Co. v. Railroad Comm'n,* 289 U.S. 287, 304 (1933); *San Diego Land & Town Co. v. Jasper,* 189 U.S. 439, 446 (1903); *FPC v. Natural Gas Pipeline Co.,* 315 U.S. 474, 586 (1942).

methodologies we used to (1) establish a unitary rate of return for ILECs' interstate access services,[225] (2) create a productivity factor for price cap ILECs,[226] (3) determine the reasonableness of depreciation rates for price cap ILECs;[227] and (4) prescribe direct costs for physical collocation service.[228]

149. We conclude that the methodology we are using for the purpose of prescribing RBOC average expense assignments ensures that GTE's rates fall within a zone of reasonableness. We adopt this approach after making a "reasonable selection from the available alternatives."[229] We considered reassigning GTE's Category 1 and Category 3 expenses by using, as a surrogate for 1996, GTE's assignment to Categories 1 and 3 as reflected in prior years' ARMIS reports. However, one problem with using company-specific data in this case is that GTE's ARMIS data for prior years reveal that GTE possibly has misallocated Category 1 and Category 3 Expenses for several years. ARMIS data for the period 1990 through 1995 show that the share of customer services expenses assigned to Category 3 exceeded the corresponding average share reported by RBOCs in every year and the percentage by which GTE's Category 3 share exceeded the RBOC average varied greatly. In 1993, GTE's share exceeded the RBOC average by 65 percent, the smallest difference for

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[225] *Rate of Return Represcription Order*, 5 FCC Rcd at 7507-508. In prescribing the ILECs' rate of return in the rate of return represcription proceeding, we (1) determined the cost of debt by calculating the average embedded cost of debt among the seven regional holding companies (RHCs) and (2) established the ILECs' capital structure by determining the average embedded capital structure of the RHCs. Furthermore, the discounted cash flow method that we used to calculate the cost of equity established a single estimate of that cost for the entire ILEC industry. *Id.* at 7508.

[226] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, Appendix C (1990). The price cap scheme adopted in this Order adjusts the maximum prices that ILECs may charge for their interstate services using a productivity factor ("X-Factor") that is based on data measuring the industry-wide average performance of the ILECs. The validity of this methodology was reaffirmed in our Price Cap Performance Review for Local Exchange Carriers, First Report and Order, CC Docket No. 94-1, 10 FCC Rcd 8961, 9027 (1995).

[227] Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Report and Order, 8 FCC Rcd 8025, 8050 (1993). In determining whether a ILEC's depreciation rates are presumptively reasonable, three factors are considered: the projected life of plant, the future net salvage value of plant, and a survivor curve. The Commission uses an industry average to develop ranges for two of the three factors, the projected life of plant and future net salvage value. These ranges are based on intervals of one standard deviation around the industry-wide mean value of the projected life of plant and future net salvage of plant underlying existing depreciation rates. *Id.* at 8050.

[228] *Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport*, CC Docket No. 93-162, FCC 97-208, Second Report and Order at paras 124-264, released June 13, 1997.

[229] *MCI Telecommunications*, 675 F.2d at 413.

any year in the period. In 1995, GTE's share exceeded the RBOC average by 186 percent, the largest difference for any year in the period.[230] Hence, although the differences varied greatly, GTE's Category 3 share far exceeded the RBOC average Category 3 share throughout the period. Similarly, ARMIS data show that GTE's Category 1 assignment was below the RBOC average in each year of that period.[231]

150. Another problem with using company-specific data in this case is that much of the prior years' data are difficult to compare to 1996 ARMIS data. In the earlier half of the 1990-1996 period, GTE did not file ARMIS reports for many smaller study areas because their study area annual revenues were under the ARMIS reporting threshold. Consequently, even if the misassignment of Category 1 and Category 3 expenses had not occurred during one of those earlier years, it would be difficult to rely on that year's data for purposes of making a corrective adjustment to 1996 data.

151. We therefore require GTE to reassign these expenses by calculating the RBOC average Category 1 and Category 3 assignments as a percentage of Category 1 and Category 3 combined, for calendar year 1996. The RBOC average customer service expense that was assigned to Category 1 as a percentage of Category 1 and Category 3 combined in calendar year 1996 was 91 percent.[232] The RBOC average customer service expense that was assigned to Category 3 as a percentage of Category 1 and Category 3 combined in calendar year 1996 was 9 percent.[233] Accordingly, we require GTE to assign 91 percent of its total Category 1 and Category 3 expenses to Category 1 and 9 percent of its total Category 1 and Category 3 expenses to Category 3. GTE must recalculate its rates to reflect this reassignment and calculate the appropriate refunds.

4. Apportionment of OB&C Expense Among Service Classes

152. After assigning a portion of customer services expenses to Category 2, Revenue Accounting Expense, which includes OB&C Expense, carriers must apportion in the

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230 FCC ARMIS Report 43-04 (1990 through 1995), Rows 7300 and 7310, for Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, U S WEST, and GTE.

231 FCC ARMIS Report 43-04 (1990 through 1995), Rows 7220 and 7310, for Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, U S WEST, GTE.

232 FCC ARMIS Report 43-04 (1996) Rows 7220 and 7300, for Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, and U S WEST. The percentage was calculated by summing Row 7220 for the RBOCs divided by the sum of Row 7220 and Row 7300 for the RBOCs.

233 FCC ARMIS Report 43-04 (1996) Rows 7220 and 7300, for Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, and U S WEST. The percentage was calculated by summing Row 7300 for the RBOCs divided by the sum of Row 7220 and Row 7300 for the RBOCs.

separations process all Category 2 expense among three categories: Message Processing Expense, Carrier Access Charge Billing and Collecting Expense, and Other B&C Expense.[234] Carriers must then allocate the OB&C Expense among five service classes based on the relative number of users of those services. These service classes consist of Message Toll, Exchange, Directory Advertising, Private Line, and TWX.[235] To determine the number of users, carriers are required to count an individual customer once for each of these services that is used.[236] A majority of customers, for example, are counted both as message toll users and as exchange users.

a. Message Toll User Counts

153. Because, under the former separations rules, carriers allocated OB&C Expense among Part 36 service categories based on user counts, the accuracy of these counts affected the accuracy of the separated interstate cost assignment and, in that way, the accuracy of calculated exogenous adjustments. If message toll user counts were understated during the period used to calculate the interstate OB&C Expense under our former rules, the resulting exogenous cost change is likely overstated because the results from the new separations rules are not affected by user counts. Specifically, an understatement of message toll users reduces the amounts of OB&C Expense that the companies allocate to message toll billing expense, a substantial portion of which is allocated to the interstate jurisdiction. In addition, the understatement increases the amounts these ILECs allocate to exchange billing expense, none of which is allocated to the interstate jurisdiction. Consequently, if the companies miscount message toll users in this way, their reported interstate assignment under our former rules (*i.e.*, using user counts) is understated. The interstate assignment under our former rules is compared to the interstate assignment under our new rules in order to calculate the magnitude of the exogenous change. If the interstate assignment is understated under the former rules, the exogenous change is overstated.

154. In the *1997 Designation Order*, the Bureau observed that the share of user counts attributed to Message Toll by GTE and U S WEST appeared to vary significantly from the corresponding shares reported by other RBOCs. The Bureau noted that both GTE and U S WEST's message toll user count share decreases exceeded the other RBOCs' decreases for 1996 and 1995 respectively.[237] The Bureau directed GTE, Pacific Bell and U S WEST to provide their user counts for Message Toll and other service classes; to explain how those

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[234] 47 C.F.R. § 36.378(b).

[235] 47 C.F.R. § 36.380(b). Because carriers no longer provide TWX service, they now allocate OB&C Expense among only four of the five prescribed service classes.

[236] *Id.*

[237] *1997 Designation Order* at ¶¶ 54 and 60.

counts were determined over the period 1990 through 1996; and to explain any discrepancies that exist between those counts and those reported in ARMIS or those used when calculating interstate costs to initialize price cap indices.[238]

(1) Discussion

155. The rules require carriers to allocate OB&C Expense to the Message Toll service class based on the relative number of customers using that service.[239] To make this allocation, an ILEC must count *all* customers billed for toll messages. This requirement notwithstanding, the record reveals that GTE, Pacific Bell, and U S WEST do not count all of their message toll customers. Specifically, these ILECs fail to count message toll customers served by IXCs using an ILEC's invoice-ready billing service.

156. The resulting understatement of message toll users reduces the amounts of OB&C Expense that GTE, Pacific Bell and U S WEST allocate to message toll billing expense, a substantial portion of which is allocated to the interstate jurisdiction. In addition, the understatement increases the amounts these ILECs allocate to exchange billing expense, none of which is allocated to the interstate jurisdiction. Consequently, this error understates their reported interstate assignment under our former rules (*i.e.*, using user counts). The interstate assignment under our former rules is compared to the interstate assignment under our new rules in order to calculate the magnitude of the exogenous change. Since the interstate assignment is understated under the former rules, the exogenous change is overstated as well.

157. We require GTE, Pacific Bell, and U S WEST to recalculate their OB&C expense by using the average percentage of message toll users among the RBOCs to determine the message toll portion of OB&C Expense. We make this prescription because, as explained above, GTE, Pacific Bell, and U S WEST understate their message toll user counts between 1990 and 1996 and fail to provide us with the information needed to determine their total message toll user counts. The *1997 Designation Order* required GTE, Pacific Bell, and U S WEST to provide detailed support for their message toll counts between 1990 and 1996. By failing to provide any data on the number of toll customers served by IXCs using a ILEC's invoice-ready billing service, the record does not contain a significant portion of the data necessary to determine interstate OB&C Expense.

158. Because GTE, Pacific Bell, and U S WEST did not provide all the data on the number of message toll customers, it is not possible to quantify the misallocation of their OB&C Expense using data from these companies. We believe that prescribing the RBOC

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[238] *1997 Designation Order* at ¶¶ 51(a)-(c), 54 and 60.

[239] 47 C.F.R. § 36.380(b).

average percentage of message toll users as an allocator of OB&C Expense yields the best estimate of the share of message toll users for GTE, Pacific Bell, and U S WEST. There are several reasons why we would expect that, if these companies had counted all of their message toll customers, the share of message toll users would be similar to the other RBOCs. First, as explained above, these companies are similar in operating size to the RBOCs, both in terms of revenues and number of access lines.[240] Second, despite wide variation among the RBOCs regarding the number of originating toll calls per exchange customer,[241] the share of customers' bills containing at least one toll call is remarkably similar among the RBOCs. The individual RBOC shares of message toll users (excluding Ameritech, Pacific Telesis and U S WEST) are in a narrow range of 43.94 percent (Bell Atlantic) to 45.68 percent (Southwestern Bell) with an average of 44.94 percent in 1996.[242] We observe that the average share of message toll user counts for the RBOCs is nearly the same as the industry-wide average of 44.96 percent (excluding Ameritech, GTE, Pacific Telesis, Puerto Rico, and U S WEST).[243]

159. The proximity of the message toll shares to 50 percent indicates that nearly all RBOC exchange customers are making at least one toll call, thereby qualifying as a toll user.[244] This implies that additional calls have little effect on the share of message toll users because such calls are most likely made by customers who have already made at least one toll call. Hence, despite the variation in number of originating toll calls per exchange user that is shown in traffic data submitted by GTE, Pacific Bell, and U S WEST, we expect that, if they had counted all users, their message toll user shares would be similar to the other RBOCs.

160. As explained above, we find that making a rate prescription on the basis of an industry average is consistent with our authority under Section 205(a) of the Communications Act because courts have consistently found in the Act a Congressional intent to grant us broad discretion in "selecting methods . . . to make and oversee rates," provided that we make a

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[240] *See supra* at para. 145.

[241] The RBOCs range of total originating toll calls (intra and interstate) per exchange customer is 543 to 1047 per year. GTE reports 803 originating toll calls per exchange customer, U S WEST reports 640, and Pacific Bell reports 1254. FCC ARMIS Report 43-04 (1996) Row 7244 for Bell Atlantic, BellSouth, NYNEX, Southwestern, GTE, U S WEST, and Pacific Bell. FCC ARMIS Report 43-08 (1996) col. (ed) plus (eg) for Bell Atlantic, BellSouth, NYNEX, Southwestern, GTE, U S WEST, and Pacific Bell.

[242] FCC ARMIS Report 43-04 (1996) Rows 7240 and 7241 for Bell Atlantic, BellSouth, NYNEX, and Southwestern Bell.

[243] FCC ARMIS Report 43-04 (1996) Rows 7240 and 7241 for Total Industry. We excluded Ameritech for reasons discussed above. We excluded Puerto Rico because its 1996 user count data are anomalous, showing the number of toll users to exceed the number of exchange users.

[244] This occurs because 100 percent counts each user twice -- once for the local exchange and once for the toll.

"reasonable selection of available alternatives" and prescribe rates that fall within a "zone of reasonableness." We find that the methodology we are using for the purpose of prescribing message toll user counts will produce rates that fall within a zone of reasonableness.

161. We make this prescription after making a "reasonable selection of available alternatives." We considered estimating message toll user counts by assuming that the number of toll users equals the number of exchange users. That assumption would result in message toll users being assigned at nearly 50 percent of the OB&C expense for these companies.[245] The assumption is unrealistic, however, because some exchange users do not use message toll service.

162. We also considered basing our prescription on the basis of user counts that these carriers reported for prior years. In light of the errors in the 1996 data, however, we will not rely on earlier data that may be based on the same faulty methodologies used in producing the 1996 user counts. It is unclear, for example, to what extent the invoice-ready counting problem existed in prior years because none of these carriers show the user and interstate message counts that were billed through invoice-ready billing in earlier years. Another problem, with regard to GTE, is that many of its smaller study areas did not file data in the first few ARMIS reporting years, making verification of the accuracy of prior years' data difficult.[246]

163. Accordingly, as explained above, we find that the most reasonable approach is to use the average RBOC message toll count (after excluding Ameritech, Pacific Telesis, and U S WEST, all of which have anomalous data)[247] as a basis for estimating the percentage of total users attributable to message toll users because we do not have firm-specific invoice-ready toll user counts. The RBOC average (excluding Ameritech, Pacific Telesis, and U S

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[245] FCC ARMIS Report 43-04 (1996), Rows 7240 through 7247, for GTE, Pacific Bell, and U S WEST.

[246] *See supra* para. 150.

[247] Ameritech's user counts exhibit numerous anomalies during the period 1990-1996. Its reported user counts for Illinois Bell and Ohio Bell, for example, decreased by 98 percent and 91 percent, respectively, between 1995 and 1996. Moreover, Indiana Bell reported that the percentage of users attributable to Message Toll remained constant at 44.04 percent in 1994, 1995, and 1996, an anomaly that indicates Indiana Bell did not update its user counts in 1995 and 1996. The Bureau directed Ameritech to refile its 1994 through 1996 ARMIS 43-04 Reports in order to correct those data or, if that is not feasible, to note that user counts during that period are incorrect. Letters from Fatina Franklin, Chief, Competitive Safeguards Branch, Accounting and Audits Division, Common Carrier Bureau of the FCC, to Roy Nonnenmann of Ameritech, dated July 3 and October 2, 1997. Although these problems in Ameritech's reported user counts seemed to cast doubt on the accuracy of its 1997 tariff filing, we here determine that Ameritech did not overstate its OB&C Expense exogenous cost increase, either because it made offsetting errors elsewhere in its calculations or because it substituted unreported allocation factors for the faulty allocation factors reported in its 1996 ARMIS Report. We therefore find no reason to add Ameritech to this portion of the investigation that addresses OB&C exogenous cost change.

WEST) was 44.94 percent in 1996.[248] We therefore require GTE, Pacific Bell and U S WEST, in recalculating their exogenous cost changes, to increase the message toll user counts in any study area in which those counts constitute less than 44.94 percent of the study area's total user counts. In such study areas, the number of message toll users shall be determined by the following formula: the number of message toll users equals the total number of non-message-toll users (*i.e.*, total number of users less the original number of message toll users) divided by 1.225.[249] Once a revised number of message toll users is determined for a particular study area, GTE, Pacific Bell and U S WEST shall use that number (together with the 1996 user counts for other services) in determining the shares of OB&C expense attributable to the following prescribed service categories: message toll, exchange, private line, and directory advertising.[250] This requirement mandates that, in study areas where the message toll share is raised to a level of 44.94 percent, the shares reported for the other three service classes must be reduced.

b. Substitution of Direct Assignment for Prescribed Allocation Factor

164. Section 36.1(c) of the rules sets forth the general principle that plant investment must be separated based on direct assignment, rather than an allocation procedure, when possible.[251] The Commission stated, however, that this general rule was not meant to create a general invitation to use direct assignment at the convenience, and to the benefit, of the filing carrier.[252] In the *1997 Designation Order*, the Bureau stated that U S WEST may have incorrectly substituted direct assignment for the prescribed allocation procedure applicable to OB&C Expense. The Bureau noted that U S WEST apparently assigned directly a portion of

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[248] FCC ARMIS Report 43-04 (1996), Rows 7240 and 7241, Bell Atlantic, BellSouth, NYNEX, and Southwestern Bell. The percentage is calculated by summing Row 7240 for these companies divided by the sum of Row 7241 for these companies.

[249] This simplified formula was derived from the following formula:
Where X equals revised message toll user count,

$$\frac{X}{\text{(total user count less original message toll user count)} + X} = 44.94\%$$

[250] As noted earlier, ILECs no longer provide TWX service, which is the fifth prescribed service category.

[251] 47 C.F.R. § 36.1(c).

[252] *See Memorandum Opinion and Order*, 8 FCC Rcd at 1563 (1993).

OB&C Expense to the intrastate jurisdiction prior to categorizing that expense.[253]

165. The Commission must determine how U S WEST used direct assignment for purposes of determining its interstate OB&C Expense under both the former and new rules. If the company does not treat direct assignment consistently under the former and new rules, the OB&C exogenous adjustment may be overstated because the majority of the directly assigned expenses are intrastate in nature.

(1) Discussion

166. As noted above, Section 36.2(e) of the rules requires direct assignment of costs associated with services or plant billed to another company. The record indicates that U S WEST used direct assignment under the former rules when it determined the jurisdictional separation of OB&C Expenses incurred by U S WEST for billing services provided by other ILECs. Therefore, for purposes of establishing the interstate assignment under the former rules, we find that U S WEST reasonably used direct assignment. This finding resolves a concern that the Bureau raised regarding an apparent anomaly in U S WEST's ARMIS data.[254]

167. We find that U S WEST violates the rules contained in Section 36.2 of our rules, however, by failing to assign directly OB&C Expenses for charges paid to other ILECs for billing services when it determines the interstate assignment under the new rules (effective May 1, 1997). To calculate an exogenous change, it is necessary to compare the separations result obtained from the former allocation procedures with that obtained from the new allocation procedures. In calculating the effect of the new allocation procedures on interstate OB&C Expense, U S WEST does not use direct assignment. Instead, U S WEST allocates to the interstate jurisdiction one-third of all OB&C Expense, including one-third of the billing expenses it had been directly assigning under the former rules. This allocation procedure violates Section 36.2(e) which, as U S WEST concedes, requires carriers to assign directly to a jurisdiction any expense already identified properly, in bills rendered by another carrier, as jurisdictionally correct.

168. U S WEST's inconsistent use of direct assignment results in an overstated exogenous cost increase. This occurred because, whereas U S WEST had directly assigned

253 *1997 Designation Order* at ¶ 51(i).

254 In the *1997 Designation Order*, the Bureau noted that U S WEST's OB&C allocation factors, reported on Row 7252 of FCC ARMIS 43-04 Report, does not match its allocation of OB&C Expense, reported on Row 7251 of that report. *See supra* at para. 5. This inequality occurs because U S WEST allocated OB&C Expense, net of the direct assignment amount, based on user counts and then added the direct assignment amount back in to Row 7252 for reporting purposes in its FCC ARMIS 43-04, which does not provide a separate line for reporting such directly assigned amounts.

only 8 percent of the directly assignable expenses to interstate under the former rules,[255] it unreasonably allocates 33 percent of those expenses to interstate under the new rules.[256] We therefore direct U S WEST to recalculate its exogenous changes based on directly assigning such expenses prior to the application of prescribed allocation procedures to the remaining costs in the base period as well as in the post-separations-change period.

5. Separation of Message Toll Billing Expense

169. The former separations rules required carriers to allocate the Message Toll portion of OB&C Expense between jurisdictions based on the relative number of intrastate and interstate toll messages.[257] These counts are important because, if interstate toll messages are understated, interstate OB&C Expense under the former rules will be too small. Because we here calculate the total exogenous change by comparing the interstate assignment under the former rules with the interstate assignment under the new rules, under which the results are not affected by the relative number of toll messages, the lower the interstate assignment under the former rules, the higher will be the OB&C exogenous cost change.

170. In the *1997 Designation Order,* the Bureau directed GTE and Pacific Bell to provide toll message counts for calendar years 1990 through 1996 and to explain how they counted these toll messages. The Bureau required them to also provide message counts for any toll messages that were excluded from reported toll message counts.[258] They were further required to explain why the interstate share of billed toll messages changed greatly between 1990 and 1996.[259] The Bureau stated that it sought this information because, at the end of that period, the interstate shares reported by GTE and Pacific Bell were far below those reported by any other RBOC. Whereas the other RBOCs attributed on average 46.6 percent of billed toll messages to interstate calls for the calendar year 1996, GTE and Pacific Bell attributed only 8.7 percent and 4.4 percent, respectively, to such calls.[260]

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[255] Letter from G. Michael Crumling, Executive Director-Federal Regulatory, U S WEST, to Cindy Schieber, FCC, at 2, dated September 12, 1997.

[256] U S WEST must assign costs before applying the 33 percent factor.

[257] 47 C.F.R. § 36.380(b)(1). These rules also require, where telegram service is offered, that telegram messages are to be included in the message count and treated as exchange service, which is entirely intrastate in nature. *Id.*

[258] *1997 Designation Order* at ¶¶ 51(d)-(f).

[259] *Id.* at ¶ 55.

[260] FCC ARMIS Report 43-04 (1996), Row 7252, for Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, and U S WEST.

a. Discussion

171. We find that GTE and Pacific Bell incorrectly counted their billed toll messages, choosing to exclude those messages associated with their invoice-ready billing services. As will be explained below, these unjustified omissions resulted in overstated exogenous cost changes. Although both carriers subsequently submitted revised message toll counts, a number of unexplained anomalies and data problems exist that cast doubt on the reliability of those revised counts. We find, for example, that even after they include the missing invoice-ready message counts, these companies' interstate shares of billed toll messages for 1996 remain far below the corresponding interstate shares reported by other RBOCs. Moreover, while GTE and Pacific Bell argue that the IXC's take-back of billing and collection functions is largely responsible for the decrease in their interstate shares of billed toll messages, they do not show that these take-backs had a significant effect on the number of toll messages billed on behalf of IXCs. Further, although Pacific Bell claims that its unusually low interstate share of billed toll messages is partly the result of the unique calling pattern of California, Pacific Bell does not quantify the effect of such a difference on that interstate share. Nor does Pacific Bell explain why the interstate share of completed toll calls originating in California was 35.5 percent, more than double the revised interstate share that it reports for billed toll messages. In addition, GTE and Pacific Bell do not support their claim that, for certain years, it is reasonable that the interstate share of billed toll messages moved in the opposite direction of the interstate share of billing revenues. We find that unusual relationship is largely, if not entirely, explained by their unreasonable practice of omitting the invoice-ready messages. Furthermore, neither GTE nor Pacific Bell adequately explains how and when it updated its message counts for the period 1990 through 1996 even though the Bureau required this explanation in the *1997 Designation Order*.

172. In view of the failure of GTE and Pacific Bell adequately to explain these anomalies and to provide required information, we find that we cannot reasonably rely on their revised 1996 message toll counts as a basis for correcting the separation of message toll billing expense. We therefore prescribe surrogate allocation factors that are derived partly from the data of other comparable ILECs.

(1) Initial Message Toll Counts

173. The former separations rules do not distinguish between toll messages billed through invoice-ready billing service and toll messages billed through message-ready billing service. As explained above, the rules require carriers to allocate the Message Toll portion of OB&C Expense based on the relative number of intrastate and interstate billed toll messages. In order to make this determination, we find that a toll message billed on behalf of an IXC must be counted regardless of how many other billing functions the ILEC is providing to that IXC.

174. We reject the claims of GTE and Pacific Bell that the decreases in their interstate shares of billed toll messages in 1995 and 1996 are attributable primarily to the IXCs' take-back of billing functions. We find that the primary reason for the decreases in their interstate shares of billed toll messages was their practice of selectively counting billed toll messages. GTE and Pacific Bell count IXC toll messages when billed through message-ready billing service but not when billed through invoice-ready billing service. Contrary to the rules, GTE and Pacific Bell exclude those invoice-ready messages despite the fact that they concede that such messages continued to appear on their customers' bills after an IXC had switched to invoice-ready billing. GTE and Pacific Bell therefore fail to show that the IXCs' migration from one billing service to the other caused a reduction in the number of toll messages billed on behalf of IXCs.

175. We also reject the arguments of GTE and Pacific Bell that invoice-ready messages should not be considered when separating Message Toll billing expense because invoice-ready billing does not involve the recording, rating, and accumulation functions and, therefore, has a minimal effect on OB&C Expense. While it is true that such messages have only a minimal effect on billing expense, this is also true for all billed messages including those that GTE and Pacific Bell choose to count.

176. Moreover, in CC Docket 80-286 the Joint Board determined,[261] and the Commission concurred,[262] that OB&C Expense predominantly consists of expenses that have little or no relationship to relative usage measurements, such as the counts of billed messages or service users.[263] Indeed, the Commission's decision to replace the former separations rules with fixed allocation factors was based largely on this lack of a cost-causative relationship between billing expense and all feasible measurements of relative usage.[264] Consequently, the individual messages associated with message-ready service have only a minimal effect on OB&C Expense. While it is true that this billing service involves message recording, rating, and accumulation, those billing functions are provided by computers. Under the separations rules, the computer costs are assigned to General Support Facilities and the associated

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[261] *Recommended Decision*, 11 FCC Rcd 12543, 12560-12563 (1996).

[262] *OB&C Order*, 12 FCC Rcd at 2684-6 (1997).

[263] Further, the Commission found that OB&C expenses largely consists of postage. With regard to Bell Atlantic, for example, the Commission found that the majority of OB&C expense is comprised of postage. (*Order on Reconsideration*, 11 FCC Rcd 4087, 4092 (1996)). Individual billed messages generally have no effect on postage because the weight of customer bills is usually under two ounces, the trigger point for a higher postage rate.

[264] *OB&C Order*, 12 FCC Rcd at 2685-86 (1997).